State of Washington
Department of Revenue

REVENUE

Excise Tax Advisory

Excise Tax Advisories (ETA) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

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This ETA was cancelled effective February 7, 2005, and is no longer in effect

Taxability of federal instrumentalities and federally created corporate entities

Federal law prohibits Washington from directly imposing taxes upon the United States and its departments, institutions, and certain federal instrumentalities. This Excise Tax Advisory explains the process for determining whether or to what extent a federal instrumentality or federally created corporate entity is subject to tax.

A "federal instrumentality" is an entity created or chartered by the United States Congress to serve a public purpose. Many federal instrumentalities are chartered as corporations, such as the Federal Home Loan Bank (FHLB).

The fact that an entity is a federal instrumentality does not necessarily mean that the instrumentality is immune from tax. The taxability of a federal instrumentality and whether or not the instrumentality is required to collect and remit retail sales/use tax depends on the benefits and immunities conferred upon it by Congress. Thus, to determine the current taxable status of federal instrumentalities, the relevant portion of the federal law should be examined.

For example, the FHLB of Seattle is one of twelve district banks established under the Federal Home Loan Bank Act. 12 U.S.C. § 1421 et seq. Each district bank is a federal instrumentality. Under 12 U.S.C. § 1433, all of the income of these district banks is exempt from taxation imposed by the United States, any state, county, municipality, or local taxing authority. However, the statute states that any real property owned by the district banks is subject to property taxes.

The FHLB of Seattle may issue notes, debentures, bonds, and other obligations. Under 12 U.S.C. § 1433, these notes, debentures, bonds, and other obligations are exempt both as to principal and interest from all taxation, except for surtaxes, estate, inheritance, and gift taxes. The result is that interest earned by a bank from one of these obligations is exempt from B&O tax.

In addition, a bank may be a member of the FHLB of Seattle, owning stock in the FHLB. The bank will periodically receive dividends earned on the FHLB stock. The dividend income is subject to B&O tax because the dividend income is not statutorily exempted from taxation.

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The Student Loan Marketing Association, commonly known as Sallie Mae, is an example of a federally created private corporation that is financed by private capital. Congress specifically exempted Sallie Mae's franchise, capital, reserves, surplus, mortgages, or other security holdings, and income from taxation under 20 U.S.C. § 1087-2(b)(2). Per statute, Sallie Mae's real property is subject to property taxes.

If Congress fails to indicate in express statutory language that the entity is exempt from state taxation, the instrumentality/corporation may nevertheless be exempt under the doctrine of implied constitutional immunity. The doctrine of implied constitutional immunity holds that without congressional action (i.e., the statutes are silent) a federally created entity is immune from state and local taxation. This immunity is derived from the United States Constitution itself. However, the doctrine of implied constitutional immunity is applicable to federally created entities only when the entity is so closely connected to the United States government that the two cannot realistically be viewed as separate entities. *Director of Rev. of Missouri v. CoBank ACB*, 531 U.S. 316, 121 S. Ct. 941, 148 L.Ed.2d 830 (2001).

The doctrine of implied constitutional immunity creates a difficult threshold for an instrumentality or federally created corporate entity to achieve. The United States Supreme Court has held that absent congressional action, the states' power to tax can be denied only under the clearest constitutional mandate. *United States v. New Mexico*, 455 U.S. 720, 738, 102 S. Ct. 1373, 71 L. Ed.2d 580 (1982)(citing *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 293, 96 S. Ct. 535, 46 L. Ed.2d 495 (1976)).

The American National Red Cross (Red Cross) is an example of an entity that was held to be immune from state taxation when its enabling statutes were silent as to its taxability. In *Department of Employment v. United States*,[1] the United States Supreme Court relied upon five factors when determining that the Red Cross was immune from state taxation. Those five factors are (1) Congress chartered the Red Cross, subjecting it to government supervision and to a regular financial audit by the Defense Department; (2) its principal officer is appointed by the President; (3) the Red Cross is obligated by statute to meet U.S. commitments under the various Geneva Conventions, to perform a wide variety of functions indispensable to the workings of the U.S. Armed Forces around the globe, and to assist the federal government in providing disaster assistance to the states in time of need; (4) although its operations are financed primarily from private contributions, the Red Cross does receive substantial material assistance from the federal government; and (5) time and time again, both the President and the Congress have recognized and acted in reliance upon the Red Cross' status virtually as an arm of the government.

[1] *Department of Employment v. United States*, 385 U.S. 355, 87 S. Ct. 464, 17 L. Ed.2d 414 (1966).

If there are additional questions regarding the tax implications for other instrumentalities or federally created entities, please forward those questions to Taxpayer Services at 1 (800) 647-7706 or at communications@dor.wa.gov.